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UNITED STATES SEED ACT

ASSISTANCE STRATEGY

FOR

LATVIA



1993-1995

**Submitted by American Embassy Riga
Approved, July 22, 1993**

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UNITED STATES ASSISTANCE FOR LATVIA 1993-1995

Latvia is a small country with a population of almost 2.7 million. It was one of the former Soviet Union's (USSR) most heavily industrialized republics. As late as the 1960's, industry was still being set up to meet USSR requirements, not Latvian needs. Large numbers of Russian workers were settled in Latvia throughout the annexation period. There are approximately 20,000 Russian troops still in the country.

The national economy has experienced significant restructuring over the course of the past two years. While large manufacturing units originally designed to meet the needs of the Soviet Union have experienced sharp declines in productivity and sales, the retail commerce, trade and transportation sub-sectors are displaying notable vitality. Cottage industries are springing up, and Riga is witnessing the steady creation of new retail establishments. Private companies are being created at the rate of almost 100 per week. What is left of the state distribution system has been rendered largely irrelevant by a booming private retail sector. State and collective farms have been broken up, creating some 60,000 new private farms. Small and medium enterprises are being rapidly privatized. Privatizing large enterprises, many crippled by collapsing markets in Russia, remains a significant challenge.

The delegation of privatization responsibilities to various ministries has engendered undue confusion and complexity but is under reconsideration by the government newly installed subsequent to the nation's first parliamentary elections. Until recently enterprises have had to submit proposals to multiple agencies and different committees within ministries which operate with little effective interagency cooperation. In the agro-industrial sector, separate legislation has been created for privatization in each sub-sector, delaying privatization transactions. This difficult juncture is exacerbated for many industries as inventories build up due to loss of USSR market demand in conjunction with diminished local purchasing power, and an unwillingness to sell at lower market clearing prices.

Official national unemployment figures of 15% significantly understate actual conditions, with unemployment as high as 30% in certain areas.¹ They do not reflect a higher level of underemployment caused by shortened work hours and forced leaves, repressed unemployment in state enterprises several months delinquent in wage payments, and a trend toward remunerating workers in-kind out of unsold inventories.

¹ As of 8/1/93, the official national unemployment figure was 5.1%.

The Latvian government's laudable haste to initiate land restitution soon after independence, has led to conflicting land claims and controversy. The original 1990 land privatization law granted rights to some current users who did not meet the 1940 land restitution criteria. A 1992 law subsequently denied these rights but did not repeal conflicting provisions in the first law. Numerous conflicting claims need to be resolved. Although the restitution law allows for assignment of alternative property, many former owners have not accepted this and are pursuing litigation. Land restitution is further hampered by overburdened land survey offices. Finally, a conscious national policy to decentralize the land privatization process subjects claims to municipal or provincial levels lends the process a further degree of complexity. A solution to these issues will not be reached in the near future.

Fiscal policy in Latvia is problematic. A cumbersome taxing structure, including turnover (value added) taxes, social insurance taxes paid by companies, taxes on business and personal income, and specific taxes on goods, imposes excessive administrative burdens on enterprises. Complex and unstable tax policies, rules and collection methods undermine taxation as a funding instrument for government and as a fiscal policy tool. Additionally, many local governments, by retaining title to urban real estate, have prevented the development of an adequate tax base. Government budgets are unclear, and fiscal decisions are seldom explained to the public, thus few citizens understand budget decisions or the government's deficit concerns. The government has given some rescue packages to farmers to compensate for delayed payments from Russia for past agricultural sales, and enterprises have been allowed to delay their tax payments.

Central Bank regulation has proven effective and has contributed significantly to the overall stabilization of the economy. A tightening of the money supply was instituted to fight inflation, and positive results are evident. Inflation was high until October 1992 and dropped to 2-2.5% per month since. By April 1993 it was reported as low as 0.3%. Though this is an important achievement towards stabilization, it also reflects the effects of repressed unemployment, the fall in purchasing power, and the downward pressure on prices of in-kind payments to workers. The tight money supply has caused an appreciation of the exchange rate and exacerbated the already sharp reduction in exports to Russia and the former Soviet republics caused by the dramatic erosion of the Russian ruble. On the other hand, imports of strategic raw materials and energy initially low, are now imported at prevailing world prices.

Traditionally, banks have obtained revenues from foreign exchange transactions. They have had little incentive or experience to deal with usual commercial transactions and services. Until recently, as much as 85% of the money supply was retained outside the banking system, because low interest rates paid on deposits reduced incentives for

savings. This reduced the stock of deposits, and limited funds available for private commercial lending. As banks are now increasing interest rates, money is returning to the banking system, and lending by commercial banks is increasing. Nonetheless, credit remains scarce and private investment is needed for long-term productivity increases and future GNP growth. Credit laws are being prepared to strengthen the commercial banking sector, and the Central Bank's payment clearing system is very effective. Latvia has heeded the warning of bank failures in Estonia, and efforts are being made to reinforce appropriate bank regulations.

There is limited legislation to support growth in the private sector. Specifically, bankruptcy laws are vague and the commercial code appears to be inadequate for domestic or foreign dispute resolution. Property rights, patent laws, tort and contract law, where they exist, rarely are adequately enforced in the absence of a strong judicial system. There are too few judges in too few courts, and low pay discourages talent from entering the judicial and legal professions.

U.S. ASSISTANCE IN PERSPECTIVE

With SEED funding expected at the six million dollar per year level over the 1993-1995 planning period, plus the availability of resources from Baltic Enterprise Fund investments in Latvia over that period, U.S. assistance should focus only on those program areas which will have the greatest impact, provide long-term solutions, strengthen key government institutions and local systems, and promote a self-sustaining development process. Development programs need to complement other U.S. and other donor programs and be synergistically coordinated to create a critical mass of expertise to resolve targeted development problems. U.S. assistance needs to provide straightforward, practical solutions that minimize management and cost burdens to the Latvian government.

The assistance program to Latvia will place a priority on a multi-faceted program to further develop and to consolidate open-market reforms. Particular attention will be given to stimulate privatization initiatives as well as to develop and adapt the legal and financial frameworks necessary to nurture private sector development. Complementarily, technical assistance and training will be given to enhance private sector business development and managerial skills. Building on its successes to date, and on solid American expertise in both the energy and environmental sectors, the assistance program will address energy policy and conservation issues that can contribute significantly to the enhancement of the Latvian private sector's market competitiveness. Not least, recognizing that pluralistic democratic institutions and open market economies are mutually supportive, the assistance program will assist government reform initiatives.

It is anticipated that U.S. assistance to Latvia during its transition to a market economy operating within a democratic society will be sustained for approximately five additional years. Assistance levels will be adjusted gradually, toward a phase out in approximately 1998, as certain activities reach their completion and new ones are initiated.

Certain activities are planned for termination or completion within the next 12 months. These include support and training to the Latvian Customs Service and assistance to the Ministry of Agriculture for the development of cereal marketing standards.

Technical assistance for the privatization and sale of select agro-industries will be initiated late in 1993 and completed no later than mid-1995. On the other hand, privatization assistance in the non-agricultural sectors, which is currently under consideration, is likely to extend into 1997.

Latvia will benefit from sustained support to industry, the emerging private sector and agricultural productivity such as is presently provided through voluntary organizations. It is anticipated that International Executive Service Corps (IESC), Land O'Lakes and Volunteers in Overseas Cooperative Assistance (VOCA) training and technical support activities will be maintained at least through 1996, with possible extension beyond this date.

The multi-faceted U.S. support to Latvia's energy sector is focused on improved industrial energy use and energy availability issues, including the enhancement of the national electrical power company's institutional capacity and energy pricing and policy development. These issues will continue to confront the Latvian economy for some time to come. Assistance to this sector is anticipated to be maintained through 1996, though certain activities may be phased out earlier.

In the financial and monetary sectors it is expected that support to the banking sector, including to the Bank of Latvia, will phase out late in 1995. Intermittent assistance on budgetary and taxation matters may appropriately be maintained into 1996.

Professional assistance on civil and criminal law, including judicial and legal training, is likely to be beneficial through 1997. It would be opportune to supplement this with a commercial law component at an early date.

The nurturing of democratic institutions can be a long-term effort whose course is not fully predictable. It is anticipated that support to emerging political institutions,

including the Saeima and political parties, would be appropriate at least through 1995 when the country's second parliamentary elections are due to occur. On the other hand, support for the development of local political institutions might usefully be extended beyond 1995. Training and material support for the development of the media (with particular attention to broadcast media) to serve the needs of an open pluralistic Latvia will continue to be necessary for some years.

It can be argued that such a degree of such support is an enduring task. It is anticipated that resources for a more intense level of support to meet the country's needs in its transition will be necessary through 1996, with some support being maintained through 1997. Support for specific educational reform efforts, including management and business training, will continue to be important contributions to the successful establishment of the private sector through 1997.

PROPOSED CHANGES IN ASSISTANCE METHODS

Consistency, momentum and accountability in the program need to be reinforced. Implementation of the program should consequently shift to:

- favor longer term U.S. technical advisory teams in lieu of numerous short-term advisors. This will enable the program to address the most important tasks with greater depth and provide sustainable results;
- foster continuity and incorporate follow-on visits by the same advisors to instill accountability both in advisors and in host country counterparts, monitor and evaluate progress, and revise assistance incrementally in line with changing conditions and the lessons learned;
- establish multi-year linkages between the U.S. public and private sector entities providing support and Latvian recipients so as to: reinforce consistency in approach, reliability and accountability, as well as to create a cost-effective and accessible network of technical advisors and information resources;
- focus and increase resources for U.S. participant training, both short and long-term, on the targets in this strategy (e.g. judicial training, local government management, marketing, agribusiness development, water pollution control); and

- encourage, whenever appropriate, close coordination of SEED funded development activities with initiatives of the Trade and Development Association (TDA) and the Overseas Private Investment Corporation (OPIC) so as to promote trade and investment supportive of sustained Latvian economic growth.

ROLE OF OTHER MAJOR DONORS AND LENDERS

Financial sector technical assistance donors include Switzerland, the Bank of International Settlements, Sweden, the United Kingdom and the International Monetary Fund (IMF). Technical assistance includes advice on institution building, banking reform, monetary reform, development of the legal framework for bank accounting rules, installation of credit analysis, and the establishment of Government Treasury bonds. In addition to technical assistance, training is also being provided including master's degree programs.

Privatization assistance, primarily by the European Community (EC), will provide policy advice on business advisory services for small and medium enterprises, credit facilities to enable small farmers to purchase equipment, diagnostic studies on ways to promote foreign investment, and assistance in restructuring agri-businesses for privatization.

Switzerland, Sweden, and the European Bank for Reconstruction and Development (EBRD) are funding assistance for private enterprise development, including training courses for policy makers on promotion of small businesses and a management training program. EBRD is also producing a pre-investment assessment for Baltic forest industries.

In the environment sector, Sweden is the primary donor. Other donors include Finland, EBRD, Canada, and the Netherlands. Assistance includes projects in pollution control and sustainable environmental development for the city of Ventspils; feasibility studies for environmental management and methods to improve treatment of organic waste; development of industrial action plans; and study of the environmental problems of the Lielupe River Basin and the Sloka sulphite mill. Training, seminars and conferences are also being provided by the donors in various environmental disciplines.

In the energy sector, Switzerland, Sweden, the United Kingdom, Canada, EBRD, and the EC are all active. Assistance includes designs for interim storage of spent fuel elements; energy pricing, potential energy project identification, an electricity study for Latvenergo, the electricity parastatal; and development of an oil pipeline. EBRD is

funding an energy sector emergency program to finance investments that will reduce oil and gas demand and to improve/diversify energy supply infrastructure. Training includes seminars in areas such as conservation.

Sweden, Finland, Canada, and the EC are working in the agriculture sector. Technical assistance is being provided to develop a maintenance network for agricultural machinery, and improve handling of manure fertilizers to protect nature. Training is being provided in forestry management, dairy management, extension and veterinary training; agricultural vocational skills; and agricultural management and production economics.

Public administration is a target for many donors' efforts including: EC, IMF, EBRD, Sweden, Germany, the United Kingdom, Canada, and Denmark. Assistance provided by the EC, IMF, and EBRD includes policies and strategies to improve and develop labor markets; social security reform; assistance with customs, statistics and public procurement policies; reorganization of the health sector; and restructuring for a democratic society. Economic management training is being provided as well as training on the democratization of government. Danish assistance is focused on local government strengthening, including training in accounting and financial management.

Judicial system assistance from the Council of Europe, the United Kingdom and Sweden is being provided to help restructure the Latvian courts and judicial system, including seminars on judicial system development.

Sweden and the Council of Europe are assisting with media development, by providing exchange programs for sports journalists; training for radio personnel; a workshop on broadcast management; and a press law workshop for newspaper associations.

Transport and telecommunications are also major sectors for EC assistance.

U.S. ASSISTANCE STRATEGY

PROGRAM GOAL #1: SUPPORT OPEN MARKET REFORMS

Unlike the northern tier countries, which maintained some degree of sovereignty within a reduced private sector economy, Latvia was governed as an integral part of the Soviet Union. Private market activity was much more limited and controlled than in Central and Eastern Europe. In Latvia's favor, the severing of its economy from Moscow-based control mechanisms was rapid and final, allowing the private sector to

bloom wherever commercial opportunity exists. As a result, the private retail and commercial sectors already appear to have reached a level comparable with that in East European countries where reforms started much earlier. Light industry is also moving quickly into private hands. In part because they have been cut off from markets to the East and are not promising investments, privatization of large enterprises may require a different approach in comparison to Eastern Europe. Because Latvia is a small country, successes -- even modest ones -- will be more visible than in the larger northern tier economies and thus are likely to be replicated.

Program Objective #1: Support Private Sector Development

A progressive expansion of the role of the private sector is essential to the market-based transformation of the Latvian economy. Since it is likely that a coalition government will be in power during the strategy period, some necessary legal and policy reforms may not come on line quickly. A more sustained foreign assistance effort may be required. Assistance will be needed to promote small and medium scale new businesses, accelerate privatization of an initial round of large scale enterprises to attract foreign investment, and strengthen the commercial banks.

Target #1: Accelerate Privatization

Very large "all-union" state enterprises, which were designed to meet the needs of the former Soviet Union, have lost their *raison d'être* and their market. Despite significant progress on privatization, Latvian state enterprises still accounted for 71.6% of industrial production and 60.2% of GDP in the first quarter of 1993. Local skills in valuation and negotiation of deals, and restructuring to break up state regulated monopolies and strengthen competitiveness are lacking. To lend momentum to Latvia's non-agricultural privatization program, it is anticipated that specialized, resident U.S. technical advisors will be sought to assist the new privatization agency (currently being established by the new government) to plan an initial round of privatizations by open tenders and to implement the resulting transactions in the non-agricultural sectors. These transactions will infuse foreign capital into enterprises in a variety of sectors.

In 1992, the agricultural and forestry sector contributed seven percent of Latvia's GDP. If foreign markets for Latvia's agricultural production in Russia can be restored, agricultural production and agro-processing could offer considerable long-term potential for growth through production diversification. To date U.S. technical assistance has facilitated legal reform and restructuring for anticipated privatization of four or five medium and large scale dairies. Until they are resolved by the new government,

outstanding issues of land restitution could impede the privatization of small and medium sized agricultural production units and agro-processing operations.

Privatization efforts in the sector will eliminate the state control of production and inputs which prohibits competition and impairs export growth. Support will be provided to the Ministry of Agriculture in response to its request for help with the privatization of up to 25 identified agro-industries. Emphasis will be placed on helping to expeditiously privatize, by competitive sale, those that are already productive, offer export potential and that promise to remain economically viable. Large enterprises that need major restructuring before they can be sold will be of a lesser priority for U.S. assistance.

Additionally, as a complement to previously provided U.S. assistance, short-term technical support will be provided to the Ministry of Agriculture's grain trade regulatory agency in establishing grades and standards.

Technical support will be provided to new and emerging private sector agricultural, industrial and commercial initiatives and focused on identified priority sub-sectors or issues through assistance provided by short-term and experienced American volunteers under the IESC and VOCA programs.

Target #2: Provide Technical Assistance and Training for Entrepreneurs, and Investment in Emerging Enterprises

Target 2.1: Provide Private Sector Training, with Emphasis on Marketing Skills

For both the agricultural and non-agricultural sectors, U.S. support will primarily be provided to strengthen in-country training programs at the publicly owned commercial and business training schools. One of the most significant projects is support, through a grant to the State University of New York (SUNY) at Buffalo, for the development of an MBA program at the Riga Business School. The school graduated its first MBAs in June 1993, and will require continued assistance for development of its library collection and for the training of teachers through 1995. Additionally, support should be maintained for academic specialists in the fields of business management and economics engaged in the development, at the University of Latvia and at three business schools, of new curricula in support of a market-oriented economy.

Target 2.2: Develop and Refine the Legal and Financial Aspects of the Business Environment

U.S. advisors with experience and expertise in European law and legal traditions will provide medium term assistance for the development of commercial legislation. A work plan, with priorities and specific targets that complement other donors' expertise in this area, will be defined as the first step in this assistance process.

A long-term resident U.S. Financial Sector Advisor at the Central Bank will continue to assist in the creation of a two tier banking system and procedures to privatize and regulate commercial banks, as well as provide policy advice to senior Bank of Latvia leadership.

In May 1993, 58 private commercial banks were registered in Latvia. Market entry was easy from 1990 through April 1993, with a minimal two million Latvian rubles as capital requirement. In April 1993, this was increased to five million Latvian rubles. This must be raised to 100 million Latvian rubles by the fifth year after a bank begins operations. Most bank personnel are inadequately trained in commercial financial services.

Although some Latvian banks have started to issue Western bank credit cards, bank services are generally confined to the most profitable and low-risk areas, i.e. international money transfers, short-term loans and currency exchange. Only two of the fifty-eight banks offer letters of credit, for example, although about 13 of them have the capital strength (over 500 million Latvian rubles) to develop a more diversified package of financial services necessary to support privatization and private sector development.

The regional U.S. Commercial Bank Advisor based in Estonia will recommend the strongest banks as targets for technical assistance and develop scopes of work for initial short-term assistance and bank training from U.S. volunteers. Building on these pilot efforts, other resident long-term U.S. advisors will continue to provide training for commercial bankers. A strong banking sector will help Latvia realize its ambition of becoming a regional center for banking and trade supporting western trade with the former Soviet republics. Such trade would optimize use of Latvia's warm water ports and of its freight handling and railroad infrastructure.

U.S. assistance in tax reform will be maintained. It may be necessary to increase support to two regional advisors for the Baltics to accommodate the expanded needs of the sub-region. Consideration will be given to helping the Latvian government establish a legal and regulatory framework for the establishment of credit unions.

Target 2.3: Provide Venture Capital and Credit to New or Restructured Businesses through the Baltic Enterprise Fund

As noted previously, bank credit is largely limited to commerce. The Baltic Enterprise Fund's credit and equity investment facility will help fill a significant current gap in long-term financing for all sectors. It is anticipated that by 1996 commercial bank lending should be on line to serve as a continuing source to finance business start-up and expansion.

Target #3: Increase Competitiveness of Latvian Industry Through Energy Efficiency

Latvia imports all of its oil, natural gas, coal and a significant amount of electricity; principally from Russia. Given the current level of energy consumption per unit of output, conservation measures are a cost-effective instrument with great potential to increase competitiveness in the manufacturing sector. Additionally, restructuring district heating systems could help realize energy savings of 20-30%.

Target 3.1: Produce Additional Energy Efficiency Demonstrations

U.S. assistance to date has produced four pilot plant conversions, including one urban heating plant, demonstrating the great cost savings that are possible through increased efficiency in energy use. Future U.S. assistance will build the capacity of Latvenergo, the national electric utility company by training its technicians to market energy efficiency technology and provide energy efficiency audits. This work may be extended to Latvijas Gaze to promote efficiency in the use of natural gas.

A partnership between a U.S. and the Latvian electrical utility is currently demonstrating the benefits of improved management practices. This should produce greater efficiency in electricity delivery.

Target 3.2: Analyze Regional Approaches to Achieving National Energy Security Objectives, Including the Possibility of Joint Investments

The regional character of Baltic energy systems (electricity grid, oil and gas pipelines) and the regional scale of the key energy facilities have helped create greater receptivity to regional pricing policies for the use of energy production facilities. There is a recognition that unreasonable pricing could lead to a loss of customers (e.g. Russia could pursue other options in the medium term). The regional electricity dispatching center based in Riga, now under the direction of the three Baltic countries, is seeking

alternative arrangements for the benefit of regional electricity importers and exporters. Electricity imports may be a cheaper alternative for Latvia than new in-country generation options currently being discussed.

The Nordic countries are proposing feasibility studies for a "Baltic ring" electricity grid that would reduce Baltic reliance on Russian energy. Per kilowatt costs of energy imports from Poland may prove to be lower under an alternative set of investments. On the other hand, the Latvian port of Ventspils may be the best location for oil imports for delivery to the Mazeiki refinery in Lithuania through a new pipeline, rather than establishment of a new import facility in Lithuania.

U.S. training and technical assistance to date has fostered greater regional cooperation in electricity pricing and contracting among the Baltic countries. Additional analysis of the energy situation is essential before major decisions and investment projects are undertaken. In the future, most infrastructure investment in regional and national energy systems will come from the EBRD, World Bank, and the Nordic countries. Complementary U.S. assistance will help Latvia select the most efficient use of its resources in this sector of high cost investments. Latvia stands to benefit from short-term U.S. assistance in the review of alternative energy-related infrastructure investment and regional pricing policy proposals. Short-term technical assistance and training under this target will help develop a Baltic regional energy plan that addresses regional alternatives as well as Latvian national solutions with emphasis on electricity inter-connection options.

Target #4: Improve Environmental Quality and Promote Pollution Prevention

Environmentally sound waste management practices in Latvia are urgently needed to restore surface and ground waters to an acceptable quality and decrease the serious threat to public health caused by heavy metals, and industrial and agro-chemical contamination. A primary target for U.S. technical assistance is surface and ground water pollution clean-up, control, and prevention in the Daugava River basin. This is Latvia's major river basin, including many major industrial polluters. Daugavpils, which is a 90% ethnic non-Latvian city, will be specifically targeted for assistance programs, in keeping with U.S. policy to provide assistance to all segments of Latvia's population. An initial survey of assistance needs was completed in May 1993 in the Daugavpils area, and a work plan is in preparation. It is expected that approximately \$100,000 per year in water pollution monitoring and computer database equipment will be needed from the U.S. in addition to training and technical assistance.

Waste minimization and pollution prevention can increase the efficiency of Latvian industry and result in municipal and other governmental cost savings, including

those from improved health. A U.S. program of assessments and industrial waste minimization demonstrations is underway in Latvia and will be expanded.

As part of its administrative reform program the Government has established a Ministry of Environment and Regional Planning which has absorbed the functions and structures of the prior Environmental Protection Committee of the Supreme Council. The Ministry will be the principal government unit responsible for environmental initiatives. U.S. assistance will help the newly established Ministry to assess options and to develop its new institutions. This will include staff training in such areas as environmental impact and risk assessment, the development and use of economic policies to further environmental objectives, and assistance in the establishment and enforcement of environmental regulations.

In cooperation with the Ministry of Environment, U.S. assistance will seek to identify appropriate means to support the Government to implement the Environmental Action Plan adopted at the Lucerne Environmental Ministers Conference. Particular attention will be given to support, in coordination with private and Non Governmental Organization/Private Voluntary Organization (NGO/PVO) efforts, initiatives that positively address the health and economic impact of environmental issues.

PROGRAM GOAL #2: SUPPORT DEMOCRATIC PLURALISM

The June 1993 Saeima elections have set the context for U.S. support for democratic pluralism in Latvia. Political parties are still developing. The process of political transformation has many parallels to that formerly experienced in other countries in the region in that a broad coalition of political forces banded together to run against the Communist Party. After the country regained its independence in 1990, the coalition broke into factions based on differences on issues and leadership. These factions are now rebuilding themselves into political parties. This is the stage at which Latvia finds itself currently.

The recent elections have set the stage to enable Latvia's political institutions to address the extremely complex and sensitive issues of citizenship and of the role and integration into Latvia of members of ethnic minorities, many of whom have settled in Latvia or been born in the country as a result of massive resettlements which occurred during the long period of Soviet occupation. The U.S., in close coordination with Latvian authorities and the appropriate representatives of the diverse segments of the population, shall seek to identify and support activities to promote inter-ethnic harmony and the effective integration into Latvian society of new Latvian citizens.

Program Objective #1: Support Government Reform

Twenty-three political parties recently contended for election to the Saeima. Many are based on a single issue or a strong leader. A number are more akin to special interest groups than genuine political parties, and few are interested in banding together to form a party based on a comprehensive platform. Despite this multiplicity of parties, Latvia's proportional electoral system which requires a party to gain at least four percent of all the votes cast in the election in order to obtain representation in the new Saeima, enabled a viable coalition to emerge from the June 1993 election. Previous U.S. assistance focused on training party officers in campaigning and party organization. In addition to continuing long-term party building, future assistance will strengthen democratic parties' ability to organize coalitions with comprehensive platforms that can govern effectively and represent pluralistic interests.

U.S. assistance on budgetary and taxation matters is being provided by a U.S. Treasury Advisor and supplemented by short-term additional assistance. This assistance will be sustained at least through 1994. It will focus on revisions to the national budget laws to instill greater accountability and clarify responsibilities. It will also assist the government to implement the decentralization of government functions. U.S. assistance, coordinated with the IMF, the EC PHARE and other donors, will promote the establishment of a more reliable mix of taxes and collection systems as well as a more equitable and efficient local and national allocation. A workplan to be developed by the U.S. Treasury Advisor will complement current Danish technical assistance to local governments.

The U.S. Treasury assistance on tax and budgetary reform will be supportive of the broader donor effort of support to reform and strengthen local government institutions to meet their increasing responsibilities to provide services as part of the Government of Latvia's overall administrative reform program.

Target #1: Support Effective Governance through Party Strengthening

In 1934, there was a coup in Latvia because Parliament was paralyzed by fragmentation between its then 28 parties. At one point during that era, there were as many as 56 political groupings in the country. To help the Saeima develop as an effective parliamentary body and avoid a repeat of the problems of that era, the U.S. will continue to provide assistance to the broad range of Latvian democratic parties, with emphasis on party-strengthening through training in intra-party coordination, coalition building, message development at both national and local levels, parliamentary procedure and policy development, drawing together international teams with practical skills in

these areas. Assistance will be provided, as well, to the development of political party institutions at the local and regional levels.

Target #2: Strengthen the Judicial System through Judicial Training

The judiciary currently is the weakest branch of government in Latvia, with the strong legislative branch appointing all judges. Latvia now has a two tier court system that consists of a Supreme Court hearing appeals and capital punishment cases, and District Courts, which include community laypersons and hear civil and criminal cases. Legislation has also been enacted that would create a new regional tier of courts between the two existing levels. Technical assistance and training is necessary to upgrade the professional performance and status of judges and other members of the legal profession, and to review the cumbersome civil, commercial and criminal justice codes. Additionally, if Latvia chooses to revise its 1922 national constitution, which was not in force during Soviet rule, or to develop a new constitution, we should look favorably on a request for constitutional reform professional assistance.

Program Objective #2: Support for Media and Educational Reform

Target #1: Enhance Access to English Language Materials

English language programs are an essential component of democracy building and restructuring of the Latvian economy. English is a prerequisite to increasing access to important legal sources for judges and lawyers. Likewise, economic reform and commercial development depend heavily on the use of the English language. SEED funding for English language training and materials should continue through the planning period.

Latvian schools and libraries are compelled to jettison fifty years' worth of Marxist-Leninist texts and replace them with materials which will promote Western democratic values, civic responsibility, an understanding of the market economy and of the rule of law. Support for the acquisition of book collections for use in targeted appropriate Latvian institutions is a vital part of U.S. efforts to promote Latvia's transition to full democracy.

Target #2: Promote the Reform of Public Media

Media reform is well advanced in Latvia. Complete privatization of the print media was accomplished in 1992. Several private radio and television stations are now operating. They and the print media face a critical lack of trained professionals at all

levels. SEED-funded projects are helping to reform the curriculum of the Journalism Department of the University of Latvia and provide training for journalists. U.S. assistance is projected to continue through 1995.

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POLITICAL ANNEX

In July 1989, the Latvian Supreme Council (Latvia's legislature) adopted a "Declaration of Sovereignty" and amended the Constitution to assert the supremacy of its laws over those of the USSR. In March 1990, democratic elections gave pro-independence Latvian Popular Front candidates a two-thirds majority in the Supreme Council. On May 4, 1990, the Council declared its intent to restore full Latvian independence after a "transitional" period. Three days later, it chose Ivars Godmanis Chairman of the Council of Ministers, or Prime Minister.

In January 1991, Soviet political and military forces tried unsuccessfully to overthrow the legitimate Latvian authorities by occupying the central publishing house in Riga and establishing a "Committee of National Salvation" to usurp government functions. Residents of Latvia confirmed their strong support for independence March 3 in a non-binding "advisory" referendum. Largely ethnic Russian regions also voted for the proposition. Latvia claimed de facto independence on August 21, 1991, in the aftermath of the failed Soviet coup attempt. International recognition, including by the USSR, followed. The U.S., which had never recognized Latvia's forcible annexation by the USSR, resumed diplomatic relations with Latvia on September 2, 1991.

Russian troop withdrawal is one of Latvia's highest priorities. The Latvian government estimates current Russian troop strength in Latvia at about 20,000 men.¹ Latvia and Russia hold regular talks on the troop withdrawal issue but progress has been slow to date. Disagreements between Latvian municipal and national authorities over control of prospective sites actually have slowed return of some Russian bases to Latvian authorities. Despite the absence of a formal agreement, withdrawals are continuing.

In October 1991, the Supreme Council passed a resolution setting out principles for a future citizenship law. A final law on citizenship is expected to be passed by the new parliament or Saeima (formed following the June 1993 national elections). Under the resolution, those who were Latvian citizens in 1940 and their descendants can claim citizenship. About two-thirds of the population have citizenship by virtue of the resolution, (about three fourths of them ethnically Latvian). As a result of Russian settlement during the Soviet period, almost 48% of the population of Latvia is ethnically non-Latvian; ethnic non-Latvians constitute a majority in Latvia's seven largest cities. The resolution proposes five "fundamental principles for future naturalization: conversational knowledge of Latvian, renunciation of former citizenship by most, length

¹As of September 1993, the estimated number of Soviet troops in Latvia is 18,000.

of residence in Latvia, a knowledge of the Latvian Constitution, and a loyalty oath. More than 85% of non-citizens in Latvia are expected to meet the duration-of-residency requirement now under consideration; however, relatively few non-citizens have yet learned Latvian.

Latvia allows dual citizenship for those who adopted another citizenship when they were forced to leave during the Soviet occupation, subject to the laws of their non-Latvian country of citizenship (in practical terms the U.S. tolerates dual citizenship, Russia does not). In addition, draft citizenship legislation calls for excluding professional members of the Soviet army, criminals, drug addicts, and certain other groups from becoming citizens.

On March 19, 1991, the Supreme Council passed a law explicitly guaranteeing "equal rights to all nationalities and ethnic groups" and "guarantees to all permanent residents in the Republic regardless of their nationality, equal rights to work and wages." The law also prohibits "any activity directed towards nationality discrimination or the promotion of national superiority or hatred." Significant portions of the 1922 constitution were reintroduced in autumn 1991, but a citizenship law and new constitution will not be adopted by the newly elected government.

The new government is a parliamentary democracy. The Saeima, a unicameral legislative body, is the highest organ of state authority. It initiates and approves legislation sponsored by the Prime Minister. The Prime Minister has full responsibility and control over his cabinet, and the President holds primarily a ceremonial role as Head of State.

In the June 5-6, 1993 elections wherein over 90% of the electorate participated, eight of Latvia's 23 registered political parties passed the four percent threshold to enter the Saeima. The Popular Front, which spearheaded the drive for independence with a 75% majority in the last parliamentary elections in 1990, did not qualify for representation. Headed by current President Guntis Ulmanis, the Foreign Minister and the president of the largest emigre community organization, the Latvia's Way coalition received a 33% plurality of votes. Once the Saeima convened on July 7, Latvia's Way joined with the Farmer's Union to head a center-right wing coalition government. Prime Minister Valdis Birkavs of Latvia's Way nominated Ulmanis of the Farmer's Union for the presidency.

ECONOMIC ANNEX

Overview: Similar to Estonia, Latvia has successfully begun the long process of stabilizing and restructuring its economy. Inflation has dropped sharply, and the fall in output has temporarily begun to abate. Unemployment will rise, however, as restructuring of industry proceeds, state enterprise tax deferrals end, and employee severance is no longer postponed by arrears in wage payments. The implementation of structural reform measures has lagged in some areas.

Real GDP fell by an estimated 33% in 1992. Though industry output was still 45% below what it was for the same quarter in 1991, the adverse impact of a drought on agricultural production was not as bad as feared. Official unemployment was still only about 2.5% of the economically active population by the end of 1992; adjusted for people working short hours or on forced leave, the unemployment rate exceeded 6%. National unemployment statistics mask the fact that some areas of the country are particularly hard hit by enterprise closures; official unemployment is highest in the Preili region at 8.1%. The average real wage for the year ending 1992 fell by about 26%.

The annual inflation rate for 1992 was 958%, but progress in restraining inflation was evident by the end of the year. Except for a small jump as a result of increases in the VAT and excise tax rates and utility prices, the monthly inflation rate fell to less than 3% by December 1992, and remained low. In April 1993, it fell even further to 0.3% per month.

In summer of 1992, Latvia began to issue the "Latvian ruble" as an interim convertible currency; after two months, it started to float independent of the Russian ruble. Then the government issued its own convertible currency, the "lats," on March 5, 1993. Tight monetary and fiscal policies and the stability of the Latvian ruble vis-a-vis the U.S. dollar throughout the fourth quarter of 1992 were important factors behind this improved inflation performance.

Net imports from the former Soviet republics rose during the second half of 1992 due to the strong real appreciation of the Latvian ruble, but this was off-set by a small trade surplus with the industrialized countries. Despite forecasts of a \$90 million balance of payment deficit for 1992, the external current account recorded a surplus of \$43 million, due to service receipts from the Latvian shipping industry.

The budgetary deficit for 1992 as a whole was about 1.4% of GDP. Despite tax measures introduced during the second half of the year, and the efforts to strengthen tax

collection, the increase in tax revenue was insufficient to cover additional expenditures. Tax arrears became a problem as they reached about 2% of GDP by the end of 1992. Meanwhile, expenditures rose much faster than expected, particularly energy-related ones, despite cuts in maintenance and investment expenditures.

Structural Reforms: Only a small number of products remain subject to price control, although the degree of subsidization -- particularly with regard to energy-related goods -- is still substantial. Utility prices were increased in October 1992, but not sufficiently to cover the costs of providing these services.

Privatization progress continues with small-scale enterprises and agriculture. By late 1992, about 60% of enterprises under the purview of municipalities had been privatized either through sales or leases; and by May 1993, some 60,000 private farms had been established. The Ministry of Economic Reform is currently reviewing 433 privatization projects for large scale enterprises. In mid-May 1993, the Government began to distribute vouchers that can be used through 1999 to buy land, apartments and shares in joint-stock or limited liability companies.

The Supreme Council appointed a committee in December 1992 to oversee the reorganization and privatization of the commercial branches of the Bank of Latvia. Bankruptcy legislation was passed in late 1991, but the administrative set-up and procedures are not functioning well. There appears to be a reluctance to allow state-owned enterprises to go bankrupt. Increases in minimum wages and pensions in May-June 1993 will hasten fiscal pressure to implement the bankruptcy law with regard to parastatals.

Two cross-cutting issues still raise concern. First, popular discontent with the economic leadership has been growing and contributed to the decision to hold parliamentary elections in early June 1993. Unfortunately, poor growth indicators reflect mainly the irreversible change in the external environment for Latvia's economy rather than the implementation of the government's program.

Second, and even more problematic, are the political economy issues that have arisen because of the large number of ethnic non-Latvians in managerial as well as worker positions that would be the major beneficiaries under some forms of privatization. It is likely that this issue will seriously complicate the privatization process as well as the implementation of many other reforms.

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